

Timber Conference 2008

NEUTRAL

Coming out of the woods?

Nigel Foo +60(3) 2084 9293 – nigel.foo@cimb.com

Six presentations

Last Friday, we held a 1-day conference in Kuala Lumpur that featured presentations by the president of the Malaysian Timber Association, Dato' Sheikh Othman Rahman and five timber companies. Response was quite good – more than 70 fund managers registered for the conference and the turnout was even better at more than 80.

Company	Presenter / Title
Malaysian Timber Association	YBhg Dato' Sheikh Othman Rahman, President
Eksons Corporation	Tang Seng Fatt, Director
Evergreen Fibreboard	Mary Lim, Executive Director Tee Kim Foom, Financial Controller Philip Wong Hwee Lih, General Manager
Jaya Tiasa Holdings	Sandra Wong, Independent Non-Executive Director John Woo, Investor Relation Manager
PriceWorth Wood Products	Andrew Lim Nyuk Foh, Managing Director Michael Chok, Finance Director
Samling Group/Lingui Developments	Cheryl Yong, Head of Corporate Communications Katherine Tan, Assistant General Manager, Finance Chong Sau Kang, Corporate Finance Manager

Highlights

Worst is over. Almost all of the speakers hold the view that the worst is probably over for the timber sector. The sector hit bottom in Feb 08 when average plywood prices was only around US\$400-410/m³. It has since rebounded by 5% to around US\$425-430/m³.

China could be the key factor. China could be one of the key factors in a major turnaround for plywood prices. According to the association president, China produces close to 27m m³ of hardwood and softwood plywood annually, of which around 8m m³ is exported. However, China's plywood production has come off since the government reduced the export rebate from 20% to 5% at the end of last year.

Start of downtrend for China's plywood output? In Feb 08, China's plywood output declined 0.36m m³ yoy and some timber players believe that it declined by another 0.2-0.3m m³ in Mar 08. If so, this could result in a sharp decline in plywood supply, which would lead to a further recovery of plywood prices in the coming months.

Declining supply of Russia's soft logs. In Apr, Russia upped its softwood log export tax from 20% to 25% and will increase it further to 80% in Jan 09. Currently, softwood log price averages US\$90-100/m³ compared to an average of US\$170-180/m³ for hardwood logs. An export tax of 80% would put softwood log price almost on par with hardwood logs. According to the timber players, suppliers are already facing difficulty sourcing logs from Russia. Further tightening of supply would benefit countries like New Zealand, Chile and Malaysia.

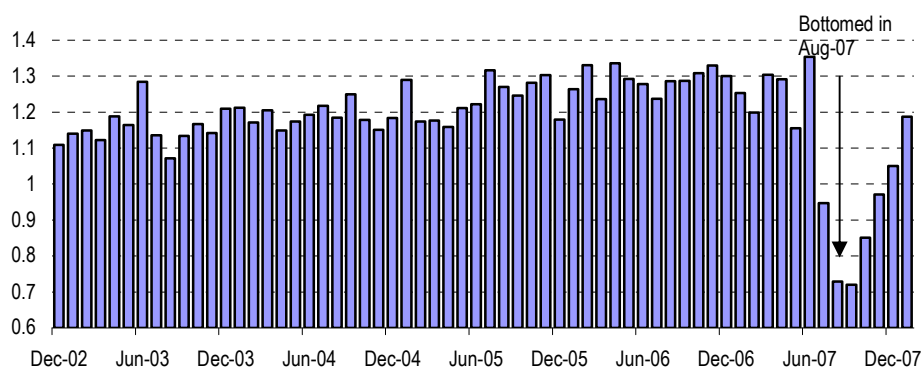
Stronger ringgit not a major concern in the long term. Timber players are not too worried about the strengthening of the ringgit as they were profitable even when the ringgit was at RM\$2.50/US\$ in the mid-1990s compared to RM3.15/US\$ currently. In the medium term, log and plywood prices will find equilibrium. Log and plywood prices are likely to head higher in the next few months as timber players pass on the rising operational costs to their customers.

Past six months the most challenging period. The past 1-2 quarters have been the most challenging for timber companies due to the confluence of several factors – weak demand from Japan, rising fuel and glue costs and strengthening of the ringgit. This was one of the main reasons why timber companies could not pass on the rising costs to their customers.

However, demand has not been an issue in Japan. Buying was affected by new building codes introduced in Japan in Jul 07, which led to confusion and caused a sharp slowdown in the country's housing starts. From 1.1m-1.2m units monthly, Japan's housing starts collapsed to 0.72m units monthly in Aug 07 and Sep 07. Since then, housing starts have recovered back to the 1.1m-1.2m unit levels.

Poor weather could affect harvesting. Heavy rain in both east and Peninsular Malaysia since Feb has affected timber harvesting activities. This could lead to log shortages over the next few months, which is likely to translate into much higher timber prices if demand from Japan picks up quickly over the next few months.

Figure 1: Housing starts in Japan (m units)



Source: CEIC

Timber association's views

Not a sunset industry. The conference kicked off with an upbeat presentation by Dato' Sheikh, president of the Malaysian Timber Association (MTA) who views the timber industry as a vibrant industry, contrary to the market's perception of it as a "sunset" industry. Malaysia's timber exports have risen from only RM14bn in 1996 to RM23.3bn in 2006, with the largest export markets being Japan, the US and China. This is equivalent to 4% of Malaysia's GDP and also 4% of its commodity export earnings. By 2020, timber exports are targeted to reach RM50bn, supported by total investments of RM25.4bn.

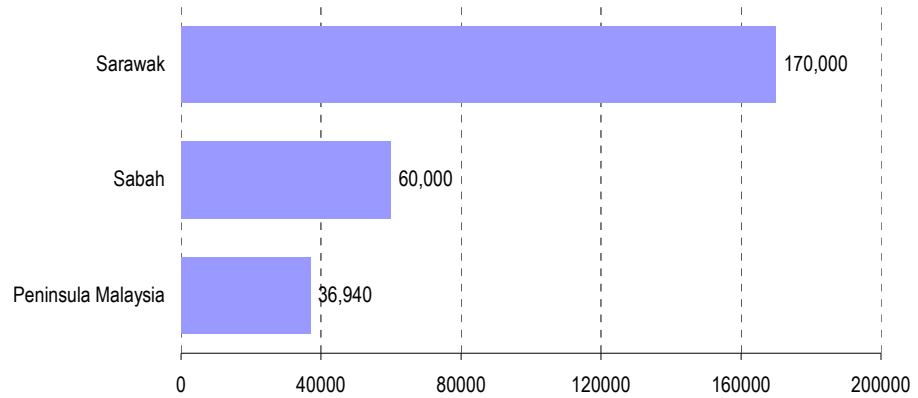
On the accusation of illegal logging in Malaysia, he cited the World Bank Study 2001 which indicates that illegal logging in Malaysia is less than 1% of total logging harvesting and said that Malaysia has tough laws against illegal logging under the National Forestry Act 1984.

Sustainable forest management. As at 2005, Malaysia had 19.52m ha of forest area, of which 3.3m ha is state land/alienated land, 1.83m ha national park/wildlife sanctuaries and 14.39m ha permanent forest reserves. Of the 14.39m ha, 11.18m ha is earmarked for timber logging and harvesting, supported by sustainable forest management. According to the Ninth Malaysia Plan, only 267,000ha of forest is only allowed to be cut annually, which is only 2.5% of the total 11.18m ha available for timber logging and harvesting activities.

Players to focus more on downstream. In the long term, Dato' expects timber companies to move towards more downstream production, i.e. move from OEM to original brand manufacturing (OBM) and original design manufacturing (ODM).

Forest plantation development will be the focus by the government and the timber players. The government has set up an SPV to disburse RM1bn for a 15-year programme to plant 375,000ha of high-value timber trees by 2020.

Figure 2: Annual allowable cut under the 9MP (ha/annually)



Source: MTA

Evergreen – targeting to be world’s top 10

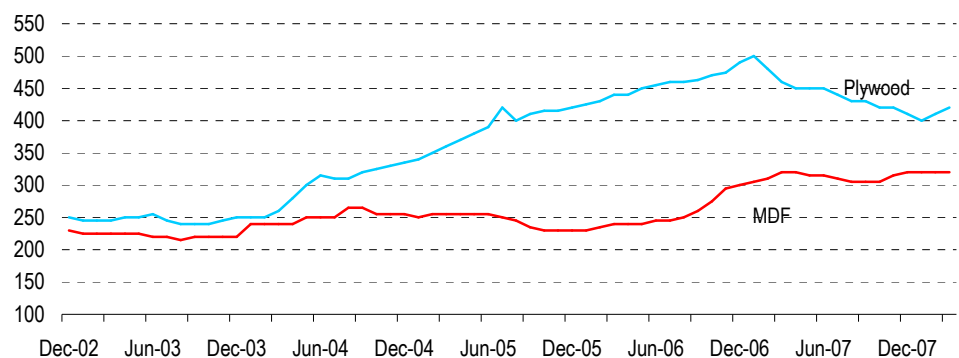
Evergreen Fibreboard is currently one of the world’s top 30 and Asia’s top five medium density fibreboard (MDF) producers. It targets to be among the world’s top 10 in the near future. By end-08, its production capacity will rise from 0.8m m³ to 1.06m m³ with eight MDF production lines in Malaysia, Indonesia and Thailand.

Stable MDF prices last year. While average plywood prices fell 20-25% in 2007, MDF prices have been stable, up 5% yoy to around US\$320/m³. This was mainly due to strong demand from Asia, particularly from China, Vietnam and the Middle East. MDF consumption in Asia Pacific is expected to increase from 20.1mn m³ in 2006 to 30.8mn m³ in 2008.

Setting up own glue plant. Due to rising glue resin costs, the group is now producing its own glue, which will help it save around RM10m annually. It has also set up its own 9.6MW biomass power plant, which could lead to around RM10m annual savings when the plant is fully commissioned in the next few months.

Need to pass on costs if ringgit goes below RM3. The group is able to absorb higher costs arising from the strengthening of the ringgit. However, should the ringgit go below RM3.00, Evergreen would need to pass on the rising costs to its customers. Regarding wood supply worries, the group is not concerned as rubberwood can be sourced from more than 1.3m ha rubber estates in Malaysia. Its immediate concern is the heavy rain in the past two months, which could cut into wood supply in the coming months.

Figure 3: Average plywood and MDF prices (US\$/m³)



Source: ITTO and Evergreen

Jaya Tiasa – an interesting indirect CPO play

Part of the Rimbunan Hijau Group. Jaya Tiasa (JT) is one of the largest integrated timber players in Sarawak. It is part of the Rimbunan Hijau group which is owned by Tan Sri Datuk Tiong. JT has 713,000ha of forest concession and is able to harvest 1.1m m³ of logs annually.

Worst is over? The group believes that the worst is probably over for the timber industry. Plywood prices have already gone up 5% over the past month on signs of a pick-up in demand from Japan. Timber log and plywood market prices will gradually rise to reflect rising fuel and glue costs and also the strengthening of the ringgit.

An interesting CPO play? What is interesting about JT is its exposure to the palm oil industry. The group has 68,000ha of plantable area and has so far planted 31,652ha. Currently, only 3,531ha have matured but by 2011, this is projected to rise to 33,000ha. The group has so far invested close to RM550m in the palm oil division and is targeting to plant 10,000ha annually over the next three years. JT planted 12,000ha with oil palms last year. Its first CPO mill will be commissioned by end-08. It has replanted 5,365ha of the 71,797ha set aside for reforestation. The group plans to replant more than 2,000ha annually.

CPO earnings to play a more major role. Palm oil contributed 15% of JT's 9MFY08 earnings. With more of its palms maturing in FY09, this division is expected to play a bigger role in the group's earnings.

Figure 4: Jaya Tiasa's crude palm oil projections

Palm oil	Apr-08	Apr-09	Apr-10	Apr-11
Planted area (ha)	33,500	44,500	57,000	67,000
Mature area (ha)	5,000	11,000	22,400	33,000
Average age (years)	4.32	4.72	4.8	5.04
FFb yield (tonnes)	60,000	139,900	291,700	471,600

Source: Jaya Tiasa

Priceworth – an attractive Sabah timber play?

Integrated player. Priceworth is one of the major integrated timber players in Sabah. It has 33,100ha of forest concessions and the rights to extract logs from an additional 34,400ha. The company was founded by its MD Andrew Lim, who owns 42.2% of the company. 80% of the logs harvested is used in its downstream activities and only 20% is exported. Downstream products include plywood, veneer, sawn timber and moulding products. Monthly downstream capacity is around 55,000 m³ of logs.

Opportunities in PNG? The group is studying opportunities in palm oil cultivation and nickel mining in Papua New Guinea. However, this is still at the feasibility study stage.

Undemanding valuations. The stock is trading at 0.4x P/BV and offers an attractive dividend yield of 4.9% based on the expected 3 sen DPS.

Samling/Lingui Developments – it can only get better

Better times ahead. The Samling Group believes that there are better times ahead for the timber sector. Demand for logs and plywood from Japan is still strong but many property projects in Japan have been deferred since the introduction of new building regulations which caused confusion. It looks like plywood prices have bottomed out as buyers recently agreed to a US\$10/m³ price increase in view of higher transportation and glue costs.

Moving into distributorship. The group is looking to reach directly its distributors or end clients, leading to higher profit margins. Samling has acquired Brewster, a major distributor of timber products in Australia. It has also taken a strategic stake in Elegant Living International, believed to be one of the largest engineered wood flooring producers and distributors in China.

No plans to take Lingui private. When asked, management indicated they have no plans to take Samling's 59.7%-owned Lingui private as they see benefits from listing in two countries, Hong Kong and Malaysia.

Eksons Corp – looking for own wood supply?

The group is looking to secure its own log supply concession but this depends on the pricing and quality. It is also looking to acquire its own tree plantations. Its Tawau biomass power plant, which is already fully commissioned, will help the group to save 60-70% in electricity cost or around RM7m-9m in annual cost savings.

Capex to maintain recovery rate. The company is also applying for carbon credits for the biomass power plant. Group capex in FY09 is estimated to be around RM16m for the upgrade of existing lines. This will help Eksons to maintain its recovery rate at around 50-51% as average log size is now smaller.

Comments

Worst is over. Last Friday's presentations are in line with our view that the worst is probably over for the timber industry.

China and Japan key factors? Developments in Japan and China could be the major turning points for the timber industry. Demand for timber products in Japan has already picked up over the past month, leading to a 5% price increase.

Heavy rain could disrupt log harvesting. Furthermore, heavy rain has affected log harvesting activities in Malaysia and this could dent log and plywood supply over the next few months, leading to much higher log and plywood prices. If China's supply of plywood (both hardwood and softwood) continues to decline in the next few months, it could reduce the industry's plywood supply.

Valuation and recommendation

NEUTRAL on sector. Although we believe the worst is over for the timber sector, we take a NEUTRAL stance until we see strong signs of a catalyst for the sector. However, selected stocks offer value. We continue to rate Lingui and Eksons Corp as OUTPERFORMs.

Sector comparisons

	Bloomberg		Price	Target	Mkt cap	Core P/E (x)		3-yr EPS	P/NTA	ROE	Div
	ticker	Recom.	(RM)	Price (RM)	(RM m)	CY08	CY09	CAGR	(x)	(%)	yield (%)
								(%)	CY08	CY08	CY08
Lingui	LING MK	O	1.31	2.49	864.1	6.9	6.6	1.7	0.5	7.1	4.6
Jaya Tiasa	JT MK	NR	3.06	NA	864.5	7.8	7.1	NA	0.8	10.5	1.0
Ta Ann	TAH MK	NR	6.80	NA	1,459.3	10.5	8.8	24.6	1.9	20.3	5.5
WTK	WTKH MK	NR	2.06	NA	902.3	10.7	9.3	26.0	0.8	20.3	4.5
Simple average						8.9	8.0	17.1	1.0	11.6	3.9
Eksons	EKSONS MK	O	0.99	2.03	162.4	3.2	3.2	26.0	0.8	17.6	11.1
Evergreen	EVF MK	NR	1.32	NA	633.6	4.8	4.2	12.0	1.1	25.7	6.0

O = Outperform, N = Neutral, U = Underperform, TB = Trading Buy, TS = Trading Sell & NR = Non Rated
Source: Company, CIMB Research

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UNDERPERFORM: Expected negative total returns of 15% or more over the next 12 months.

TRADING BUY: Expected positive total returns of 15% or more over the next 3 months.

TRADING SELL: Expected negative total returns of 15% or more over the next 3 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to outperform the relevant primary market index over the next 12 months.

NEUTRAL: The industry, as defined by the analyst's coverage universe, is expected to perform in line with the relevant primary market index over the next 12 months.

UNDERWEIGHT: The industry, as defined by the analyst's coverage universe, is expected to underperform the relevant primary market index over the next 12 months.

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